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By C. William Wittman, Jr.

The establishment of the accounting profession was the outgrowth of the age-old custom of checking books for the purpose of discovering or safeguarding against irregularities. In the beginning very little of the work was constructive. However, in the early days of the profession, the devising and installing of cost systems and the revision of so-called systems already in existence constituted a large part of the public accountant's constructive work. Even today, there is hardly an accountant in public practice who is not called upon either to install or revise cost systems.

Many cost systems in use today are the results of the accountant's endeavor to educate the manufacturer to the necessity and advantages of accurate costs. Most manufacturers are alive to the necessity of taking advantage of improvements in productive methods and scientific inventions, but at the same time these manufacturers have been slow in adopting suggestions offered by accountants with reference to the determination of operating costs.

The progressive executive is not satisfied with yearly determination of costs, the accuracy of which depends upon the care with which the physical inventories are taken and priced. He does not want to guess throughout the year the probable results of operations, and once each year have this guess confirmed by a disclosure of profitable operations, or have the guess proved false by actual losses. He does not wish the sum total of his knowledge of operations embraced in one conclusion. Why then should not the progressive accountant be desirous of determining more frequently than once each year the cost of conducting his practice and his net profits?

Cost accounting is a branch of general accounting whereby the three elements of cost (material, labor and overhead) are computed for the product made or service rendered in such manner that the management can obtain accurate and prompt information regarding the activities of the business and can exercise intelligent control over them. General accounting shows merely the total net profit or loss of a business as a whole, while cost accounting discloses the profit or loss on each unit. For public accountants, the unit is the engagement. How many public accountants have applied to their own business the principles of cost accounting which for years they have urged upon their clients, and how many determine the cost and net profit of each engagement as it is concluded?

The first record prepared by the public accountant as a part of his system of finding "job costs" is an engagement memorandum. As engagements are obtained, memoranda should be prepared disclosing the date of contract or agreement, client's name and address, character of engagement, fees to be charged and any other data pertinent to the particular work. Upon completion of an engagement, the date and amount of invoice to the client and the invoice number are entered on the engagement memorandum. Since these memoranda should be numbered as the engagements are obtained, after completion of the work they are filed numerically. A cross index to engagement numbers is made available by filing the working papers numerically according to engagement number and by maintaining an alphabetical index, by clients, of all engagements.

Most firms require their employees to prepare time reports, or at least they should, because these reports are the source of information from which clients are billed for engagements at per diem rates, and they are one of the sources of the cost data. There are many different periods at which time reports are prepared, but a very convenient plan is to require their submission on the tenth, twentieth and last days of each month.

These reports should show on the reverse side the daily time, in hours, devoted to each engagement, with a brief description of the character of work performed. They should also contain a record of traveling expenses incurred on out-of-town engagements. The front of the time report is a summary of the daily information on the reverse side. It should show the engagement number, client's name, number of days, and/or fractions of days devoted to each engagement, traveling expenses, total productive days, total general office time and unemployed time. In some instances the number of working hours constituting a day is eight, while in others it is seven. For present purposes, seven hours may be considered as a day's time, and all time on a given engagement will be charged on this basis. The time reports should be filed alphabetically, by periods.

In order to accumulate the time of all employees chargeable to a given engagement, the details of the front side, or summary, of time reports are entered on a client's time record (see form 1, page 40). There is little on this form that requires explanation. The initials represent the persons giving time to the engagement, while the figures under the initials are the days consumed, i. e., 5–3 means 5–3/7 days, 0–3 means 3/7 days, etc.

At the end of each month the time of each person and the time of all persons for each period are added and proved. This computation is the basis for issuing invoices to clients at the agreed fees. The column headed "Cost" will be explained later. After the invoice is issued, the client's time record should be filed with the duplicate copy of the invoice: before doing this, however, it will be necessary to determine the per-diem costs of all the firm's employees.

A suggested form of per-diem costs is presented as form 2 (page 41). The total productive days on this form are taken from the time reports; the salaries and overhead expenses from the ledger accounts and underlying records. The total expenses shown on this statement should be in agreement with the difference between total expenses on the current trial balance and total expenses on the preceding month's trial balance of the firm's books.

It will be observed that the overhead is distributed on the basis of salaries. This may be criticized, because the higher-salaried employees are charged with the largest amounts of overhead. But if the overhead is distributed on the basis of productive days, then the persons who have the greatest number of productive days will bear the largest amount of overhead—this seems even more inequitable than the salary basis. In any event, practically all overhead distributions, while in many instances they are presumed to be made on one of the many so-called scientific bases, are for the most part arbitrary. The salary basis of distribution will, therefore, serve the present discussion. A certain amount of the time of branch managers and stenographers will be unproductive because of attention to miscellaneous general office routine, and therefore a percentage of these salaries should be charged as overhead.

At this point the query arises as to the method of determining costs of time of partners or branch managers whose compensation is a participation in the firm's net profits, or who have a salary and in addition a profit-sharing agreement with the firm. A similar question is what shall be done about the individual practi-

FORM I

CLIENTS TIME RECORD

NAME AND ADDRESS OF CLIENT The John Doe Company, 25 State Street, New York City ENG. MEMO. NO. 106

CHARACTER OF ENGAGEMENT Balance Sheet Audit as of December 31, 1925, and prepare Federal Income Tax Return

ESTIMATED TIME TO COMPLETE Between 2 and 3 months NO. OF ACCOUNTANTS REQUIRED 4

ADDRESS REPORT TO John Doe, President

BASIS OF CHARGE $35.00 per day for Seniors; $25.00 per day for Juniors; Typing at customary rate

DATE OF TIME REPORT	PERSONS EMPLOYED ON ENGAGEMENT																				COST	
	D.H.D.		J.A.H.		D.F.J.		E.M.T.								Stenos				TOTAL		MONTH	AMOUNT
	TIME	EXP.	TIME	EXP.	TIME	EXP.	TIME	EXP.	TIME	EXP.	TIME	EXP.	TIME	EXP.	TIME	EXP.	TIME	EXP.	TIME	EXP.		
6/10/26	4.1		7.2		3.6		4.2												19.4			
20	2.0		0.3		5.2		6.1												13.6			
30	6.1				7.1		8.0												21.2			
	12.2		7.5		16.2		18.3												54.5		June	$709 63
7/10	1.2		2.1																3.3			
20	3.4		8.2																11.6			
31	5.6		3.4																9.3			
	10.5		14.0																24.5		July	321 80
8/10	4.1		6.2												7.2				17.5			1031 43
20															3.1				3.1			
31															4.6				4.6			
	4.1		6.2												15.2				25.5		Aug.	253 00
TOTAL	27.1		28.0		16.2		18.3								15.2				105.1			$1284 43

Per-diem costs
June, 1926

Name	Total productive days	For the month — Expenses for June — Salary	Overhead	Total	Average cost per diem
Daves, D. H.	18	$ 208.33	$ 77.99	$ 286.32	$15.91
Hendrix, J. A.	23	188.65	70.56	259.21	11.27
Johnson, D. F.	29	262.50	98.17	360.67	12.44
Leonard, C. D.	22	300.00	112.20	412.20	18.74
Hanning, P. B.	34	250.00	93.50	343.50	10.11
Singer, F. T.	24	162.50	60.77	223.27	9.30
Timms, E. M.	27	275.00	102.85	377.85	13.99
Branch manager—½	16	175.00	65.45	240.45	15.03
Average cost—accountants	193	$1,821.98	$681.49	$2,503.47	$12.97
Average cost—stenos. . . .	41	95.81	35.83	131.64	3.21
Average cost—all.	234	$1,917.79	$717.32	$2,635.11	$11.26

Overhead—for the month

Salaries—proportion of:	
Branch manager—½	$175.00
Stenographers—⅔ . .	191.61
	$366.61
General expense	71.00
Office rent	150.00
Office supplies.	94.15
Telephone and telegraph	20.56
Traveling expenses. . . .	5.00
Depreciation	15.00
	$717.32
Overhead percentage . .	37.4%

Accumulated average cost—year 1926

Accountants:			
To May 31, 1926. . . .	752	$10,186.39	$13.55
June, 1926	193	2,503.47	12.97
	945	$12,689.86	$13.43
Stenographers:			
To May 31, 1926. . . .	133	$ 431.66	$ 3.25
June, 1926	41	131.64	3.21
	174	$ 563.30	$ 3.24
All.	1,119	$13,253.16	$11.84

Average productive days per man, per month

June, 1926.	24
1926 to date	22

Form 2

tioner who draws no salary. In each instance, for cost purposes at least, a salary should be set up at a monthly rate of the approximate cost to employ a competent person in a similar capacity on a straight salary. This is especially applicable to individual practitioners because many of them have entered individual practice after spending some time, although perhaps only a training period, with a firm of public accountants. While on the staff they were paid a monthly salary, regardless of their productive time. If such persons had chosen to leave the accounting profession to accept private employment, the change of employment would have been made at an increased salary. It is, therefore, suggested that the person who enters individual practice in such circumstances would be unfair to himself unless he charged his business with a salary greater than that which he received from the public-accounting firm. To do otherwise would be to ignore the progress one has made as a result of his changed employment.

To revert now to costing the engagements, upon completion of the per-diem cost statement (form 2), the cost of all productive time for a given month should be computed. These costs are determined by applying the average costs of time of all accountants for the month against the total time of these accountants on each engagement, and by a similar computation for the stenographers; the aggregate cost of all employees being entered on the client's time record (form 1) under the column "cost." The cost of each engagement for a given month, thus determined, is scheduled and the sum thereof should agree with the total expenses for that month as disclosed by the per-diem cost statement. After this costing process the total cost of completed engagements is determined by adding the monthly figures in the "cost" column of the client's time record, and then this latter record is filed with the duplicate copy of the invoice issued to the client. The total cost of each completed engagement deducted from the fees charged gives the net profit from each engagement.

On this basis one may prepare a statement which reflects the wisdom of the public accountant and his skill in administering the affairs of his practice. That statement is here called "Fees accrued, and profit or loss on each engagement" (see form 3, page 43). The method of calculating the cost and net profit of each engagement, just explained, should be exercised on the duplicate copy of the invoice. Then the net profit or loss from the engagement should be entered on the statement "Fees accrued, and profit or loss on each engagement."

It is the policy of most accountants to record in their books as a credit to fees and a charge to the client the amount of fees on each invoice as mailed—or rather monthly, thus maintaining the books on an accrual basis. The traveling and other expenses will have been charged direct to the client as reported. Under these conditions, the costing process and the resultant profit or loss on engagements are subject to an accurate proof. Briefly, the proof is the adjustment of the surplus and profit accrued at the close of a given month so that the adjusted result will agree with

Fees accrued, and profit or loss on each engagement June, 1926

Invoice number	Client	Total invoice including expenses	Fees entered	Profit or (loss)
301	Cooper and Company.......	$ 64.29	$ 64.29	$ 35.47
302	John Doe Company........	169.48	119.29	34.17
303	Monarch Oil Company......	161.43	161.43	89.43
304	Johnson Bit Company......	15.00	15.00	7.00
305	John Moore and Sons.......	556.18	456.14	265.14
306	Trya Lumber Company.....	310.00	250.00	(15.00)
	Non-charge time:			
	A. B. C. Company.......			(20.00)
	Totals...............	$ 1,276.38	$ 1,066.15	$ 396.21
	Adjustments			
199	F. M. Smith and Company: reduction of invoice.......		$ 50.00	$ 50.00
	Total for June, 1926................	$ 1,276.38	$ 1,016.15	$ 346.21
	Total this year to June 1...........	22,000.00	20,000.00	10,000.00
	Total 1/1—6/30, 1926..............	$23,276.38	$21,016.15	$10,346.21
	Total all years prior to 1/1, 1926.....	11,000.00	10,000.00	5,153.79
	Total all periods to 6/30, 1926.......	$34,276.38	$31,016.15	$15,500.00

Proof of engagement profit

Surplus—January 1, 1926....................	$ 2,000.00	
Net profit accrued—June 30, 1926...............	12,000.00	
Costs of uncompleted engagements at June 30, 1926....................................	1,500.00	$15,500.00

Percentage of profit based on fees

1926 to date................	49.23%
All periods to date..........	49.97%

Form 3

the accumulated net profit from engagements as shown by the statement "Fees accrued, and profit or loss on each engagement." This computation is nothing more than the addition to surplus and current accrued net profit (as shown by the books) of the sum of accumulated costs of uncompleted engagements taken from a schedule of these costs based on the client's time record (form 1).

After all this—and it requires little time each month to make available data of extreme importance to the accountant—he can then view monthly the trend of his business. This final statement answers for the accountant the important questions: Have I been wise and prudent in my policy of obtaining new engagements by competitive bidding, and as a consequence accepting engagements for a fee considerably smaller than my competitor's? Are my net profits on fees, both as to amount and percentage, sufficient for the capital invested and the time devoted to my business? Is my staff properly balanced, i. e., is there a proper distribution of seniors and juniors? Who are my most costly men, and why do they cost more than others? What causes the fluctuations in my per-diem costs, and how do these costs compare with those of other accountants? Have I justified the practice of taking engagements at a loss, or at a return slightly in excess of cost with the hope (rarely realized) of increasing the fees or building up goodwill? Have I vindicated the policy of maintaining a large staff because of a great volume of work at a small percentage of net return, or would my business prosper by reduction of staff and obtaining increased fees which really are measured by the value of my service? These questions and many others can be answered intelligently if the accountant will take time to prepare and study the statements discussed.

Much has been said, and even more written, about the destructive force of competitive bidding. Most reputable firms concede that the practice is inimical to the best interests of the profession. But now it is possible to go a step further and confirm this consensus by weighing the financial results of engagements obtained through competitive bids. The accountant should not be satisfied with "some net profit" on his fees, but should compute the percentage of profit on each engagement, because only through this can he build up profits by eliminating unprofitable engagements.

One finds accountants everywhere taking engagements at ridiculously low fees with the prospect of later increasing these fees on repeat engagements, and, moreover, with the idea that such practice establishes goodwill. In the first instance it is absurd to work for less than cost, for it is highly improbable that subsequent engagements from the same client will return increased fees. The age has not yet arrived when all business executives, and even many bankers, are fully aware of the many and varied valuable services rendered by the public accountant. As a consequence we hear the cry that accountants' services already are too costly. It is rare to find a manufacturer or merchant selling his goods below cost, or slightly in excess of cost, except as a last resort, when perhaps his capital is frozen in slow-turning or obsolete stock. But the accountant is unlike the manufacturer or merchant; he does not have goods to turn over, and certainly he should not have frozen capital or services. The answer to the unfounded theory of building up goodwill by taking engagements at reduced fees is that goodwill is never established by carrying on business at a loss. It is created by rendering a valuable service to a satisfied client at a fair return for the service. There are many large manufacturers distributing commodities throughout the whole world, but their goodwill and well known reputation are built up through profits—their annual statements show this almost without exception.

The profession is now concerned with the difficult task of bringing about a change from the calendar year to a fiscal year which is the natural business year of many enterprises. Until this is accomplished, the accountant's practice will be seasonal, and there will be months during the summer when his productive time is at a minimum. This situation results in low per-diem costs during the heavy season of the first few months in each year, and increased costs thereafter. This condition can be adjusted, in a measure, by an arrangement with the client to audit the books periodically throughout the year instead of auditing the entire twelve calendar months at one time. Whatever is done, the costs will be greater during the period of least activity. All seasonal businesses are confronted with the same condition. A few of them have endeavored to keep the monthly costs uniform by application of the moving average. But it is believed that this is unnecessary for the accountant, because his costs should not fluctuate very materially. Then, too, a large part of the high costs on a given number of engagements will be offset by lower costs, especially in those cases where the audit is "kept current."

All those accountants who for years have devoted considerable time to their clients' costs, and have attempted to show their clientele wherein costs are excessive, wherein economies can be effected, and in what instances long-established policies are unwise and costly, should set out to determine the same vital elements of their own practice. They should begin to feel the pulse of their practice and adopt such corrective policies as will enable them to chart the course of their professional activities.